MASSACHUSETTS ELECTRIC COMPANY
Docket No 96-100

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *Should electric distribution companies, at least initially, be required to meet requests from customers for Basic Service with purchases from the PE? (p.iii)*

Comment

As discussed in the comments, the creation of a PE will require the creation of a broad consensus within the New England Power Pool ("NEPOOL") that does not exist today. In fact, the negotiations that led to the creation of NEPOOL Plus revealed very little support for revising NEPOOL to become a spot pool at this time.

Examples of types of issues that must be resolved before a spot pool can be established are the following:

1. Today the New England Power Exchange ("NEPEX") dispatches all generating units based on cost. How would the dispatch be performed under the PE spot pool? How would minority shares of jointly owned units and contract entitlements be handled in a dispatch based on bids?

2. Today NEPOOL requires that all entities serving load satisfy a capability responsibility or pay a penalty. Under the PE spot pool, what rules would exist to ensure that entities serving load procure adequate generating capacity?

3. Today loss compensation service is handled as a load adjustment in NEPOOL's own-load billing process. How would loss compensation be accomplished under the PE spot pool?

4. Today NEPEX directs the owners of the generating units that can provide load following service at the lowest cost to provide that service, and the owners of those units are compensated for their production costs through the automatic generation equipment control fund. How would load following service be provided and paid for under the PE spot pool?

5. Today the responsibility for providing operating reserve and the penalty for not having sufficient operating reserve is handled through the NEPOOL own-load dispatch. How would operating reserve be provided and paid for under the PE spot pool?

6. Today NEPOOL's central dispatch ensures that load and generation within the control area are in balance, and the differences between a single entity's load and its generating resources are compensated for via NEPOOL's own-load billing system. How would energy imbalance be handled and compensated for under the PE spot pool?

7. Retail choice can be provided without installing sophisticated telemetering on every home and business as long as each home or business is included in the own-load dispatch of a NEPOOL member. Would every home or business require sophisticated telemetering under the PE spot pool and, if not, what rules would be established to determine the demand and energy of each customer and the aggregate demand and energy of the customers of each supplier?

Basic service as contemplated by the Department cannot be provided until a PE is designed and implemented in a way that answers all of the above questions, and has the support of a broad consensus across New England. Mass. Electric's proposed standard offer, on the other hand, can be implemented with only minor modifications to existing NEPOOL rules. The standard offer is a practical option for providing default service to customers by 1998.

Comment prepared by or under the supervision of Jeffrey D. Tranen.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *Does the resolution of market power issues in New England require the establishment of an ISO that has no corporate relationship to any market participant, and if not, how can membership and governance rules be established so that no owner can control the operations of the ISO and no group of participants can exert excessive influence? (p.14)*

Comment

As described in the comments, on May 3, 1996, the NEPOOL Executive Committee voted to include an ISO for the Pool in its NEPOOL Plus vision to be filed later this year at FERC. Although the testimony of Professor Richard Gilbert shows that the New England market will be workably competitive even without an ISO, the creation of an ISO within NEPOOL, the adoption of standards of conduct and the functional separation suggested by FERC and the Department should resolve vertical market power concerns associated with the operation of the transmission system in New England.

On the question of governance, the Executive Committee vote contemplates independent employees and governance. The vote provides the "ISO will have employees that are independent from any of the NEPOOL participants," and "will have an independent governance board that will not be controlled by any single participant or class of participants." This approach should meet the Department's standards.

Comment prepared by or under the supervision of Jeffrey D. Tranen.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *What is the minimum level of responsibility necessary for an ISO in New England to maintain power system reliability? To what extent would the configuration of generation and transmission resources in the New England region limit an ISO's ability to rely solely on the nominal dispatch schedules of market participants (consistent with bilateral transactions) and the PE for the purpose of generating unit dispatch? (p.16).*

Comment

An ISO in New England will require the same type of responsibility to maintain power system reliability as NEPEX has today. It is not clear how much additional flexibility could be given to market participants to dictate the dispatch of their facilities. A major issue that will need to be resolved is which participant has the right to dictate the operation of generating units. The existing unit contracts and joint ownership agreements have not had to address this issue in the current NEPOOL framework.

Comment prepared by or under the supervision of Jeffrey D. Tranen

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *Should an ISO have control over the dispatch of all generating units in order to facilitate transmission congestion pricing in the region? How would ISO control facilitate this? (p. 17)*

Comment

An ISO should have control over the dispatch of all generation resources as well as control over operation of the transmission resources. This dual control would enable an ISO to manage the integration of these two resources to minimize cost and to establish objective pricing signals.

Comment prepared by or under the supervision of Jeffrey D. Tranen.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *Please discuss the operational and competitive benefits and drawbacks of allowing an ISO broad control over dispatch, at least initially, and phasing down the extent of ISO dispatch control over time as the new market structure takes hold and market participants and operators of distribution systems gain experience with the new structure? If such an approach is feasible, discuss possible timing and other criteria for its implementation. (p.17)*

Comment

We see no meaningful benefits from a transition from an ISO with central dispatch to a decentralized dispatch system. We believe that the NEPOOL central dispatch system has greatly enhanced the reliability of the regional electric system and has brought substantial economic benefits to the NEPOOL participants and their customers. We support continued central dispatch.

Comment prepared by or under the supervision of Jeffrey D. Tranen.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request. *Should an ISO have responsibilities beyond the minimum necessary to ensure reliability? Should there be an expanded role for an ISO during the transition period in order to facilitate the development of a competitive generation market? How would the ISO, in its expanded role, facilitate such development?(p. 17).*

Comment

We believe that an ISO should have the role envisioned for it by the Department in its minimum requirements, by the FERC in Order 888, and by the proposal contained in the NEPOOL Executive Committee vote. That role is as a neutral and reliable implementer of the rules developed by regulators, reliability councils and by the market participants themselves.

Comments prepared by or under the supervision of Jeffrey D. Tranen.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *How to set forth methods for establishing an appropriate threshold measurement of market power in Massachusetts and in New England, on the applicability of the Hirschman-Herfindahl Index ("HHI") and on the appropriate definition of the market (e.g. geographic area, generating capacity, etc.) for the calculation of the HHI, if applicable. (p. 30)*

Comment

The method and calculation of the HHI in power supply markets is discussed in detail in Mass. Electric's initial filing in the testimony of Richard J. Gilbert. As Professor Gilbert explains, in order to analyze market power, one must define the relevant product market and the relevant geographic market, measure the market's concentration by using the Herfindahl-Hirschman index ("HHI") as a screen, and if necessary, address other factors that would affect competition in that market.

In this proceeding, the relevant product markets are the market for wholesale electricity supply in the near term and generation capacity in the long term. Barriers to entry are low in the retail electricity supply market, so there is not likely to be any concern about the exercise of market power at the retail level. This is demonstrated by the ongoing New Hampshire retail competition pilot, in which approximately 30 suppliers are competing to serve 50 MW of load. Similarly, the long term generating capacity market does not raise competitive concerns due to the lack of entry barriers, as FERC has recently found. FERC Order 888 at p. 63-66.

The relevant geographic market should encompass, at the very least, the NEPOOL region and should be expanded to include imports from New York, Pennsylvania, Ontario, and elsewhere. It would make no sense to limit the geographic market to Massachusetts, since the generation available to supply Massachusetts comes from many sources outside the state.

For purposes of measuring concentration in a restructuring proceeding such as this, the HHI screening threshold should be 2500, as the U.S. Department of Justice recommended in the Oil Pipeline Deregulation case. Oil Pipeline Deregulation: Report of the *U.S. Department of Justice* (May, 1986), pp. xi. Markets with an HHI below this level should be deemed sufficiently competitive to permit deregulation to proceed. The Department incorrectly uses the 1800 HHI figure prescribed by the Department of Justice/Federal Trade Commission Merger Guidelines. That number was developed as a screen for mergers. A higher degree of market concentration should be tolerated in deciding whether to consider deregulation, due to the social costs of continued regulation.
In its order, the Department expressed concern with the fact that HHI's for New England were above 1800, thereby failing to pass the Merger Guidelines screen. Order, p. 30, fn. 21. Even assuming that 1800 is the proper HHI screen for a deregulation proceeding (which it is not), these HHI's were calculated assuming **no imports** into New England. When imports are added, the HHI's drop below 1800. The total supply of generation within New England, plus the full transfer capacity for imports from New Brunswick and New York, yield an HHI of 1665 for the summer and 1642 for the winter. Consequently, the concentration of the relevant market would not be likely to concern the Department of Justice in a merger case, let alone raise any market power concerns in a deregulation proceeding such as this.

Since the HHI is only a screening device, indicating the potential for market power concerns (not present here) the analysis could end at this point. However, further analysis strengthens the conclusion that the post-deregulation market will be workably competitive. There will be low barriers to entry of new participants, given the small efficient minimum size of new generating units and the presence of open and comparable transmission access. Collusive behavior will be unlikely, given the differing interests of suppliers and the overall level of excess capacity.

This conclusion is supported by the report of Richard Hartman and Richard Tabors on behalf of the Massachusetts Attorney General, which states that there is "minimal opportunity for any [generation] owner to exercise market power in the New England region" based on its analysis of ownership of marginal cost generating units. (Hartman and Tabors, p. 5). They conclude further that the New England "region is, effectively, free of transmission constraints at the present time," thereby leaving "little to constrain the location decisions of either new supply or demand in the region". Id., p. 10. This reinforces Dr. Gilbert's view that entry barriers are low, buttressing his conclusion that market power would not be a concern.

Comment prepared by or under the supervision of Richard J. Gilbert.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *Would it be feasible to implement a policy whereby an existing generating unit would be required to achieve compliance with new source performance standards within three years of its original retirement date if it will operate past that date? What costs would be involved? What would be the role of the Department in supporting relevant environmental agencies in implementing such an approach? (p.39)*

Comment
Implementing a policy whereby an existing generating unit would be required to achieve compliance with new source performance standards if it operates beyond its original requirement date would be technically difficult, potentially very costly, and largely ineffectual. The technical difficulty arises from the need to define new source performance standards for each existing generating unit to determine what is the appropriate level of emissions from that unit. Under the federal Clean Air Act, new source performance standards are specific emission requirements that have been established on an industry-by-industry basis. These national emission standards apply to new sources as they are defined in the regulations, i.e., a source constructed or significantly modified after some date certain as specified in the rules. Another way to establish new source standards could be to rely on best available control technology ("BACT") or lowest achievable emission rate ("LAER") analyses. These are basically case-by-case determinations that result in emission reduction requirements taking into account such factors as cost, technical feasibility, and energy usage. Determining BACT or LAER for existing utilities would be time consuming and difficult. Bringing existing utilities into compliance with the standards once determined could be extremely costly.

Massachusetts Electric has proposed in *Choice: New England* a plan for reducing emissions that could be implemented for New England Power Company ("NEP"), the generating affiliate of Massachusetts Electric. While there may be principles underlying Massachusetts Electric's proposal for the NEP units that could be applied to others, the details cannot reasonably be applied to other electric generating units. The details of an emission reduction plan must be tailored to each company's unique circumstances.

Moreover, establishing a policy requiring units in Massachusetts to achieve significant emission reductions beyond what is required by law does not make sense unless sources in other areas of the country make significant reductions. Without reductions from upwind sources, overall air quality in Massachusetts will not be significantly improved even if emissions were reduced from Massachusetts generating plants.

Comment prepared by or under the supervision of Jeffrey D. Tranen.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *Would implementation of an unbundling/market proxy plan (such as that proposed by BECO) in 1997 by all Massachusetts retail distribution companies significantly change what otherwise would be the dispatch order of generating units in New England? Why? What implications, if any, would this have for the practicality and desirability of implementing this plan? What implications, if any, would this have for the collection and mitigation of stranded costs? (p. 53)*

Comment

The implementation of E-plan would have little if any effect on the order of dispatch in New England. Regardless of consumption decisions made by customers, NEPOOL will continue to dispatch the generating units of all NEPOOL participants on an economic basis. Since E-Plan participant customers will not have a choice of suppliers, the same suppliers will continue to operate their respective resources to meet the load of retail customers in their respective service territories. The load of these customers will continue to be included in the supplier's "own load" dispatch. Assuming there is no other impact to the generating units owned and operated by the present suppliers serving Massachusetts customers, NEPOOL will continue to operate generating units based on their economics.

There will be little if any effect on the mitigation of stranded costs under the E-Plan. The E-plan is similar in nature to time-of-use rates which have been in effect in Massachusetts for many years in varying degrees. On the other hand, if pricing reflects the potential volatility of the short-run market, customers participating in the E-Plan may alter their pattern and/or level of consumption in response to the published daily pricing signals. This may, in turn, result in ultimately lower short run marginal costs incurred by the customers' suppliers.

As explained in the comments, implementing short run energy pricing may lead to increased costs of metering and billing. Accordingly the pricing should be an option for large customers. It should not be required. Implementation of E-Plan will not affect stranded costs.

Comment prepared by or under the supervision of Richard P. Sergel.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *What advantages or disadvantages exist for requiring contracts for power generated from divested plants with the distribution affiliate of the company that sold the generation assets? (p. 56).*

Comment

Contracts back to the distribution affiliate of the selling utility will reduce the potential economic benefits which industry restructuring is expected to have. Plants that should be shutdown or are marginal in a market environment might remain open because of the support provided by the contract. Evidence of this effect exists in the independent power industry today. In cases in Connecticut, New Hampshire, and Maine, long-term contracts between utilities who no longer need the power and IPPs whose marginal costs of production exceed the current market price, act as a disincentive to the IPPs to shut down their inefficient facilities. The DPU's proposed rules seek to use market forces to create an environment in which plant owners will have an incentive to make efficient decisions. The Department should not weaken those market forces by requiring contracts for the power generated from divested plants back to the distribution affiliate.

Comments prepared by or under the supervision of Michael E. Jesanis.

Request for Comment by the Department of Public Utilities
Order of May 1, 1996

Request *Are there special considerations regarding nuclear units that require different or distinct treatment from other types of generation under DPU 95-30 principals on stranded costs?(p. 59)*

Comment

The public has an overriding interest in assuring the safe decommissioning of nuclear plants. Notwithstanding the Department's desire to provide for the recovery of most stranded costs within ten years from the introduction of choice, the Department should ensure that the amount of a utility's access charge fully funds all costs independent of operation for as long as it takes to decommission the plants safely and to dispose of the waste.

Ongoing operating costs of nuclear plants should be subject to the market and full competitive pressures.

Comment prepared by or under the supervision of Michael E. Jesanis.